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Sustainability Through Transparency and Definitions: A Few Thoughts on Regulation (EU) 2019/2088 and Regulation (EU) 2020/852

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Against the background of the EU policy goal to reorient capital flows towards sustainable investment, this article will review the extent to which Regulation (EU) 2019/2088 (Disclosure Regulation) and Regulation (EU) 2020/852 (Taxonomy Regulation) are effective in terms of increasing investor confidence to invest in sustainable economic activities. In this respect, particular focus will be on the relationship between the disclosure obligations and the terminology ensuing from the two regulations.

Keywords: Disclosure Regulation, Taxonomy Regulation, Sustainable Finance, Transparency, ESG, Sustainable terminology, Green terminology, Sustainability

1. INTRODUCTION

The EU takes its climate policy seriously and is rapidly building a legal framework to contribute to making the European economy sustainable, following up on its commitment to the Paris Climate Agreement and to the 2030 Agenda setting the Sustainable Development Goals (SDGs) of the United Nations.[1] An important concept in this legal framework is sustainable finance. This term refers to the process for the financial sector to take into account environmental, social and governance considerations (hereinafter: ESG considerations) when making investment decisions.[2] The EU focuses on reinforcing ESG aspects in the financial sector, hoping that this will lead to more long-term investments in sustainable economic activities.[3]

The EU wishes to design a legal framework to channel investments towards sustainable enterprises, and with good reason. In order to achieve the European climate and energy goals by 2030, a yearly investment gap of almost 180 billion will have to be closed.[4] In the words of the European Commission (hereinafter: the Commission): 'The magnitude of the investment challenge requires mobilising both the public and private sector'.[5] and 'Long-term signals are needed to direct financial and capital flows to green investment and to avoid stranded assets'.[6]

The Action Plan on Financing Sustainable Growth has fleshed out this policy goal.[7] To realize more sustainable investments, the investor confidence in green investments needs be increased.[8] In this light, the action plan underlines the necessity for trade and industry in general, and the financial sector in particular, to be transparent about sustainability. Transparency about sustainability issues is an essential condition to enable market participants in the financial sector properly to assess the long-term value creation of companies and their management of sustainability risks. More transparency is also necessary because (non-professional) investors are currently often investing contrary to their (sustainable) beliefs. This attitude-behaviour gap is attributed to a lack of communication by financial service providers.[9]

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1 With the 2030 Agenda for Sustainable Development, the UN intends to create a global framework for sustainable development. The key theme in the 2030 Agenda are the seventeen Sustainable Development Goals. The 2030 Agenda focuses on economic, social and environmental sustainability.

2 Action Plan: Financing Sustainable Growth, COM/2018/97 final 2.

3 Action Plan: Financing Sustainable Growth 2; The European Green Deal, COM/2019/640 final 15 et seq. *See also* AFM, *Trendzicht* 19 (2020).

4 Action Plan: Financing Sustainable Growth 2.

5 The European Green Deal 15.

6 The European Green Deal 16–17. Stranded assets are assets that are included in the balance sheet but may not be able to be used or may turn out to be worth much less due to changing laws and regulations. In this respect, one may think of the oil and gas reserves of oil companies that are included in the balance sheet but will never actually be used because of the energy transition and the increasing demand for clean energy.

7 The goals in the action plan are: (1) reorient capital flows towards sustainable investment in order to achieve sustainable and inclusive growth; (2) manage financial risks stemming from climate change, resource depletion, environmental degradation and social issues; and (3) foster transparency and long-termism in financial and economic activity.

8 Action Plan: Financing Sustainable Growth 2–4.

9 Eurosif, European SRI Study (2018), www.eurosif.org/wp-content/uploads/2018/11/European-SRI-2018-Study.pdf (accessed 13 Aug. 2020) 76. *See also* Action Plan: Financing Sustainable Growth 5–6; High-Level Expert Group on Sustainable Finance, Financing A European Economy (Final report), at 27; V. Colaert & A. van Caenegem, *Duurzaamheid gefinancierd: Plichten van financiële dienstverleners*, Working Paper No. 2020/2, at 1, www.ssrn.com/abstract=3607146 (accessed23 Oct. 2020).

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Designing effective transparency obligations is easier said than done. To set effective transparency obligations, the aspects that parties to which the obligations apply are to be transparent about must be clear. This requires a common (sustainable) terminology. It is that terminology that is often the bottleneck. Sustainability terms are quite often disputed terms. In a study from 2017 as to the term circular economy, for example, no less than 114 different definitions of this term were reviewed.[10] Another example is the term Corporate Social Responsibility. Due to permanent conceptual disputes about the interpretation of this term, there is no wide consensus about its substance. As a result, this term is less measurable, which affects, or at least gives rise to doubts as to, the scientific (and practical) relevance.[11]

The same holds true for the term ‘sustainable’. The action plan sees a lack of clarity regarding the (exact) meaning of this term as a contributing factor behind the gap in investments in sustainable economic activities. This lack of clarity on the concept may also lead to greenwashing. Leaving it up to the market or the Member States to define the term ‘sustainable’ is not an option. If Member States use their own taxonomies to indicate what sustainable activities are, there is a risk of divergence among the various national frameworks. This could lead to fragmentation of the market.[12]

Member States could, for example, use substantively different taxonomies as a basis to label sustainable financial products. A label entails the formal recognition of compliance with the sustainability standards underlying the label. If labels for financial products are based on different standards for each Member State, it becomes more difficult to compare the various financial products. This will lead to obscurity, which is not in the interest of investor confidence. Furthermore, economic parties trying to attract Union-wide investments would have to satisfy different criteria for each Member State in order to obtain a sustainability label for their activities. The lack of congruent criteria will, thus, lead to uncertainty and an increase in costs of compliance.[13]

The Action Plan: Financing Sustainable Growth has resulted in three regulations: (1) Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector (Disclosure Regulation),[14] (2) Regulation (EU) 2019/2089 on sustainability benchmarks[15] and (3) Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 (Taxonomy Regulation).[16] The regulations largely focus on the relationship between the financial service provider and the investor, and the realization of new ESG disclosure obligations, and create a harmonized ‘sustainable’ terminology.

Against the background of the EU policy goal to reorient capital flows towards sustainable investment, this article will review the extent to which Regulation (EU) 2019/2088 (Disclosure Regulation) and Regulation (EU) 2020/852 (Taxonomy Regulation) are effective in terms of increasing investor confidence to invest in sustainable economic activities. In this respect, particular focus will be on the relationship between the disclosure obligations and the terminology ensuing from the two regulations.

Firstly, the Disclosure Regulation will be presented (paragraph 2). Subsequently, paragraph 3 will discuss the Taxonomy Regulation, followed, in paragraph 4, by an evaluation of the two regulations and an elaboration on their mutual relationship. This article will end with a conclusion in which the extent to which the two regulations are effective in terms of increasing investor confidence in green investments (paragraph 5) will be discussed.

2. THE DISCLOSURE REGULATION

The Disclosure Regulation regards the promotion of transparency of sustainability aspects in financial products and services. This is to enable end investors to make a more informed decision on their investments. Furthermore, transparency should help fight greenwashing. The regulation intends to reduce information asymmetries in principal-agent relationships where financial market participants and financial advisers act as agents for end investors.[17]

To realize this goal, financial market participants and financial advisers must be transparent as to whether and how they integrate sustainability risks in their investment policy. Furthermore, information must be provided as to whether and how they take into account adverse sustainability impacts in their processes. Financial market participants and financial advisers must provide information, by way of precontractual and current disclosure, as to the sustainability of their financial products.[18]

10 J. Kirchherr, D. Reike & M. Hekkert, *Conceptualizing the Circular Economy: An Analysis of 114 Definitions*, Resources, Conservation and Recycling 229 (2017).

11 J. van Oosterhout & P. P. M. A. R. Heugens, *Much Ado About Nothing: A Conceptual Critique of CSR*, ERIM report series research in management Erasmus Research Institute of Management ERS-2006-040-ORG (2006). *See also* T. E. Lambooy, *Corporate Social Responsibility* (IVOR no. 77) (2010), para. 1.2.4. *See also* A. Kolk, *Het eind van maatschappelijk verantwoord ondernemen, of het begin?* (Inaugural Lecture Series/Faculty of Economics and Econometrics), Amsterdam: Vossiuspers UvA (2003). *See* on confusion as to the term ‘sociale onderneming’ (social enterprise), the letter to the Lower House of Parliament on *Kabinetsinzet Sociaal Ondernemen* 2 (10 July 2020); KPMG & Nyenrode Business Universiteit, *Onderzoeksrapport Stimuleren van (h)erkenning van sociale ondernemingen* (2020).

12 Action Plan: Financing Sustainable Growth 2–4.

13 Position of the Council on the adoption of a Regulation of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment 2018/0178 (COD), and amending Regulation 2019/2088 on sustainability-related disclosures in the financial services sector, COM/2020/155 final, at 6 (Brussels, 23 Apr. 2020).

14 Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 Nov. 2019 on sustainability-related disclosures in the financial services sector.

15 Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 Nov. 2019 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks.

16 Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088.

17 Preamble under 8, 10 and 19 Disclosure Regulation.

18 Article 1 Disclosure Regulation. *See also* preamble under 8 Disclosure Regulation.

To come to a coherent and consistent application of this regulation, key terms in this regulation have been given a 'harmonized definition'. As a result, the Disclosure Regulation, just as the Taxonomy Regulation, provides legally binding definitions for a number of terms, for example the term 'sustainability risk'. This is an ESG event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment.[19] Another example. The term 'sustainability factors' means: environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters.[20] These two terms are necessary for a proper weighing of possible adverse impacts in an investment decision. Furthermore, these terms set the background against which the term 'sustainable investment' can be defined. The term 'sustainable investment' consists of three elements. Firstly, a sustainable investment must be an investment in an economic activity that contributes to realizing an environmental or social objective. Secondly, such investment may not significantly harm any of those objectives. Finally, the investee company must follow good governance practices.[21]

The Disclosure Regulation applies to financial market participants and financial advisers. Financial market participants are insurers providing investment-linked insurance products, providers of pension products, asset managers, and managers of investment institutions, venture capital funds, and social entrepreneurship funds.[22]

Financial advisers include entities providing investment or insurance advice. This includes insurance intermediaries providing insurance advice on insurance-based investment products and credit institutions, investment companies, and AIFMs and UCITS managers providing investment advice.[23] Where an entity carries out activities of both a financial market participant and a financial adviser, the nature of the relevant activity will determine whether, in the relevant situation, it is governed by the rules for financial market participants or for financial advisers.[24] Incidentally, the regulation offers Member States the option to grant an exemption from the application of the regulation for advisory services provided by insurance intermediaries and investment companies with fewer than three employees.[25]

Article 3 Disclosure Regulation requires financial market participants to publish information on their websites about their policies on the integration of sustainability risks in their investment decision-making process, or their investment or insurance advice process. If financial market participants and financial advisers consider adverse impacts of investment decisions or investment or insurance advice on sustainability factors, they must provide information as to how they do so. If such parties do not consider adverse impacts on sustainability factors, their websites must indicate this and substantiate the reason for not doing so.[26] Furthermore, financial market participants or financial advisers must provide information as to how their remuneration policies are consistent with the integration of sustainability risks. The remuneration structure must incite a healthy and effective sustainability risk management and should not offer any incentive for taking excessive risks.[27]

In the precontractual disclosures, financial market participants or financial advisers must provide transparency on integration of sustainability risks in investment decisions or investment or insurance advice. Financial market participants must thereby also discuss the likely impacts of sustainability risks on the return of the financial products they make available. Financial advisers must be transparent about the likely impacts of sustainability risks on the return of the financial products they advise on.[28]

Financial market participants must substantiate towards investors how a financial product that has a sustainable investment as its objective has attained that objective.[29] Where, in precontractual disclosures, a financial product promotes environmental or social characteristics, it must be explained to investors how those characteristics are met.[30] As an illustration: if an index has been used as a reference benchmark in promoting environmental or social characteristics of a financial product, information must be provided as to how that index is relevant.[31] For the financial products referred to in Article 8(1) Disclosure Regulation or in Article 9(1), (2) of (3) Disclosure Regulation, financial market participants must be transparent on their website and in periodic reports as well.[32]

The disclosures in this regulation are in addition to the existing sectoral regulations at European and national level. To ensure the orderly and effective monitoring of compliance with this regulation,

19 Article 2(22) Disclosure Regulation.
20 Article 2(24) Disclosure Regulation.
21 Article 2(17) Disclosure Regulation.
22 Article 2(1) Disclosure Regulation.
23 Article 2(11) Disclosure Regulation.
24 Preamble under 7 Disclosure Regulation.
25 Article 17 Disclosure Regulation. *See* preamble under 6 Disclosure Regulation.
26 Article 4 Disclosure Regulation.
27 Article 5 Disclosure Regulation.
28 Article 6 Disclosure Regulation.
29 Article 9 Disclosure Regulation.
30 Article 8 Disclosure Regulation.
31 Article 8(1) Disclosure Regulation.
32 Articles 10 and 11 Disclosure Regulation.

Member States should rely on the competent authorities already designated under those rules.[33]

The regulation has applied since 29 December 2019 in respect of duties delegated to the European supervisory authorities and the European Commission to set technical regulating standards. The remaining part of the regulation will come into effect on 10 March 2021, with the proviso that the periodic reporting within the meaning of Article 11(1)-(3) Disclosure Regulation will apply from 1 January 2022.[34] The Commission will evaluate the application of the regulation by 30 December 2022.[35]

3. THE TAXONOMY REGULATION

The Taxonomy Regulation provides a framework of congruent criteria to establish how and to what degree an investment qualifies as environmentally sustainable. Social and governance sustainability are not (yet) addressed in the Taxonomy Regulation. To establish the degree of environmental sustainability of an investment, the environmental sustainability of the economic activity in which the investment is made must first be established.[36] Article 3 Taxonomy Regulation contains four cumulative conditions to be satisfied by an economic activity to qualify as environmentally sustainable. In other words: the four criteria jointly constitute a definition – albeit a complex one – of the term 'environmentally sustainable'.

An economic activity is environmentally sustainable if, firstly, it contributes substantially to at least one of the environmental objectives listed in Article 9 Taxonomy Regulation, namely: (1) climate change mitigation; (2) climate change adaptation; (3) the sustainable use and protection of water and marine resources; (4) the transition to a circular economy; (5) pollution prevention and control; and (6) the protection and restoration of biodiversity and ecosystems. The regulation works out in further detail for each environmental objective what qualifies as a substantial contribution by an economic activity to achieving that objective.

Secondly, the economic activity may not significantly harm any of the other environmental objectives described in Article 9 Taxonomy Regulation. For example: an economic activity causing substantial greenhouse gas emissions is not consistent with the objective under (1): 'climate change mitigation'. Another example: An economic activity that leads to substantial inefficiencies in the use of materials or an increase in the production, incineration or removal of waste will significantly harm the objective under (4) 'the transition to a circular economy'.[37] Whether an activity causes significant harm will be tested against the environmental impact of the activity itself and the environmental impact of the products and services provided by that activity. In this respect, particular focus is on the production, use and end of life of those products and services.[38]

The third requirement is that the company carrying out the economic activity must implement procedures to ensure that the economic activity is in line with minimum standards regarding – in sum – human rights, working conditions, and dealing with local communities.[39] In this respect, Article 18 Taxonomy Regulation refers, inter alia, to the OECD Guidelines for Multinational Enterprises[40] and the UN Guiding Principles on Business and Human Rights.[41] Through Article 18, the Taxonomy Regulation considers what is called the 'social foundation'[42] of sustainability. These minimum safeguards intend to create a social foundation that a company carrying out an economic activity should not sink through.

Finally, the economic activity must comply with the 'technical screening criteria'.[43] The technical screening criteria determine in concrete terms if and to what degree a specific economic activity 'contributes substantially' or 'significantly harms' the various environmental objectives. Given the rapid development in science and technology, the screening criteria must be updated on a regular basis to safeguard consistency with the state of the art.[44] The technical input for the screening criteria is provided by the multi-stakeholder 'Platform on Sustainable Finance' (hereinafter: the 'platform').[45]

The platform advises the Commission on the development, analysis and revision of technical screening criteria. Furthermore, the platform advises the Commission on the possible application of the criteria to future policy initiatives, for example initiatives in the field of social sustainability objectives. Incidentally, the Commission is also advised by the 'Expert Group of the Member States on

33 *See* Directives 2009/65/EG, 2009/138/EG, 2011/61/EU, 2014/65/EU, (EU) 2016/97, (EU) 2016/2341, and Regulations (EU) No. 345/2013, (EU) No. 346/2013, (EU) 2015/760, and (EU) 2019/1238. Preamble under 11 Disclosure Regulation.
34 Article 20 Disclosure Regulation.
35 Article 19 Disclosure Regulation.
36 Article 1(1) Taxonomy Regulation.
37 Article 17 Taxonomy Regulation.
38 On the precautionary principle of 'no significant harm', *see* Regulation (EU) 2019/2088, Preamble under 17; Art. 17 Taxonomy Regulation.
39 Article 18 Taxonomy Regulation provides that the economic activity must be in line with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, including the principles and rights set out in the eight fundamental conventions identified in the Declaration of the International Labour Organization on Fundamental Principles and Rights at Work and the International Bill of Human Rights.
40 https://www.oesorichtlijnen.nl/documenten/publicatie/2014/12/8/oeso-richtlijnen-nederlandse-vertaling (accessed 9 Oct. 2020).
41 Also known as the 'Ruggie framework'. *See*, https://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf (accessed 9 Oct. 2020).
42 K. Raworth, *Doughnut Economics: Seven Ways to Think Like a 21st Century Economist*, Vermont: White River Junction (2017).
43 *See* Art. 10(3), Art. 11(3), Art. 12(2), Art. 13(2), Art. 14(2), or Art. 15(2) Taxonomy Regulation.
44 Article 19(5) Taxonomy Regulation.
45 Article 20(2) Taxonomy Regulation.

Sustainable Finance' (hereinafter: the expert group).[46] This expert group advises the Commission on the suitability of the technical screening criteria and the platform's approach to the development of those criteria. At the same time, the expert group acts as a conduit between the Commission and the Member States in that respect. Article 24(2) Taxonomy Regulation requires the Commission to inform the Member States on the main output of the platform, so as to be able to exchange views on a timely basis. This information is provided to the Member States through the expert group.

The Platform on Sustainable Finance consists of representatives of the European Environment Agency, the European supervisory authorities, the European Investment Bank, and the European Investment Fund, the European Union Agency for Fundamental Rights, together with experts representing the private sector, including experts representing financial markets, trade and industry, experts representing civil society, and experts representing academia.[47] By way of a delegated act, the Commission can establish and update the technical screening criteria. In this respect, the Commission must, having regard to the advice from the platform, consider whether such criteria will lead to stranded assets, adverse impacts on financial markets, and risks of incoherent incentives for sustainable investments.

The Taxonomy Regulation is firstly applicable to measures adopted by Member States or by the Union that set out requirements for financial market participants in respect of financial products or corporate bonds that are marketed as environmentally sustainable.[48] In this respect, one may think of national sustainability labels.

Secondly, the regulation focuses on financial market participants that make available financial products.[49] Pursuant to the Disclosure Regulation, financial market participants (and financial advisers)[50] are subject to ESG transparency obligations. These transparency obligations are supplemented pursuant to the Taxonomy Regulation. A financial market participant whose financial product promotes environmental or social characteristics or has sustainable investment as its objective (Article 8(1) and Article 9(1) and (2) Disclosure Regulation) must, pursuant to the Taxonomy Regulation, in addition to the disclosure obligations ensuing from the Disclosure Regulation, provide information as to how and to what degree the investments underlying the financial product, support economic activities that meet the criteria for environmental sustainability.[51]

Where a financial product does not come under the aforesaid articles of the Disclosure Regulation – i.e. does not have sustainable investment as its objective or promote environmental or social characteristics – the Taxonomy Regulation requires that the disclosure be accompanied by the following statement: 'The investments underlying this financial product do not take into account the EU criteria for environmentally sustainable economic activities'.[52]

Pursuant to the Taxonomy Regulation, the obligation to provide (more) transparency in terms of sustainability is also imposed on companies that are required to disclose a non-financial statement or consolidated non-financial statement within the meaning of Article 19 bis and Article 29 bis of Directive 2013/34/EU. These are large (parent) undertakings[53] being public-interest entities[54] that, as at the balance sheet date, have an average staff exceeding 500 employees during the financial year. These companies must include a non-financial statement in their (consolidated) management report in any event regarding environmental, social and staffing affairs, respect for human rights and anti-corruption and anti-bribery aspects.[55] The Taxonomy Regulation provides that, in addition to the (consolidated) non-financial statement, information must be provided as to how and to what degree the company's activities are associated with environmentally sustainable economic activities. This particularly regards information as to the proportion of the turnover derived from products and services, the proportion of the capital expenditure and the proportion of the operating expenditure related to economic activities that qualify as environmentally sustainable within the meaning of the Taxonomy Regulation.[56]

It is up to the Member States to monitor, through their competent authorities,[57] that financial market participants comply with their disclosure obligations under Article 5, 6 and 7 Taxonomy Regulation. With a view to possible infringements of the aforesaid articles, the Member States adopt measures and penalties. Such measures and penalties must be effective, proportional and dissuasive.[58]

The taxonomy will become applicable to all environmental objectives in two stages.[59] The taxonomy will become applicable to

46 Article 24(1) Taxonomy Regulation.
47 Article 20(1) Taxonomy Regulation.
48 Article 1(2)(a) Taxonomy Regulation.
49 Article 1(2)(b) Taxonomy Regulation.
50 Article 2(11) Disclosure Regulation.
51 Articles 5 and 6 Taxonomy Regulation.
52 Article 7 Taxonomy Regulation.
53 Article 4 Directive 2013/34/EU.
54 Including banks, insurers and security issuing institutions. For the Netherlands, *see* Art. 1(l) of the Dutch Audit Firms (Supervision) Act [*Wet toezicht accountantsorganisaties*].
55 Article 19 bis (1) and Art. 29 bis (1) Directive 2013/34/EU.
56 Article 8 Taxonomy Regulation.
57 Article 21 Taxonomy Regulation in conjunction with Art. 14(1) Regulation (EU) 2019/2088.
58 Article 22 Taxonomy Regulation.
59 Article 27 Taxonomy Regulation.

the first two environmental objectives (climate change mitigation and climate change adaptation) with effect from 1 January 2022. The Commission will adopt the relevant technical screening criteria by 31 December 2020. For the other four environmental objectives, the technical screening criteria will be adopted by 31 December 2021. The taxonomy will subsequently be applicable to all the environmental objectives with effect from 1 January 2023.

An evaluation of the Taxonomy Regulation will be published by the Commission by 13 July 2022. After that, inter alia the development of the technical screening criteria, setting up mechanisms for monitoring compliance, and the effectiveness of the regulation will be reviewed every three years.[60] By 31 December 2021 the Commission will publish a report describing how the scope of the regulation can be extended to, inter alia, social sustainability objectives.[61]

4. EVALUATION

Both the Disclosure Regulation and the Taxonomy Regulation are important steps in the direction of a harmonized 'green' terminology. Furthermore, the regulations promote transparency as to the sustainability of financial products and investment and advisory policies. Nevertheless, several assessment frameworks need to be further developed in the regulations. The Disclosure Regulation requires the relevant financial service providers to make an assessment of environmental, social and governance sustainability risks. The question that arises is how to interpret the terms environmental, social and governance sustainability. The Taxonomy Regulation offers financial service providers some degree of certainty as to the term 'environmental sustainability'. Some degree, because the technical screening criteria that co-define the term 'environmental sustainability' are yet to be adopted. It is important that these criteria are unambiguous. If not, it can still be uncertain whether, in a specific case, something is or is not environmentally sustainable. Given the many parties and interests that come together within the Platform on Sustainable Finance and the Expert Group of the Member States on Sustainable Finance, adopting and updating the technical screening criteria may be a challenge. And it will become even more of a challenge as the scope of application of the Taxonomy Regulation is extended to other types of sustainability. This in addition to the question whether the updating of the Taxonomy Regulation can keep up with the developments in science and society.[62]

Apart from the foregoing, the Taxonomy Regulation in any event does not (yet) contain any definitions of social and governance sustainability. It would, therefore, seem that, in assessing social and governance risks, financial service providers will have to rely on their own assessment frameworks or national labels. Given the foregoing, this may, to some extent, also apply to the assessment of environmental sustainability risks. This seems to be a serious gap in effectiveness of the regulations. For Member States and/or financial service providers to have to create their own conceptual frameworks in order to meet the requirements of the regulations would be diametrically opposed to the envisaged objectives of transparency and a common terminology.[63]

The objections referred to above may (partially) prove to be of a temporary nature. For the Taxonomy Regulation is designed to grow along with the developments. Article 26(2) Taxonomy Regulation expressly provides that the scope of application of the regulation may be extended. For example by including criteria to determine the degree to which a financial product is socially sustainable. As stated earlier, by 31 December 2021 the Commission will publish a report explaining how the scope of the regulation can be extended to, inter alia, social sustainability objectives. This will also include those economic activities that have no, or a (highly) adverse, impact on environmental sustainability. For a relevant framework for the assessment of social and governance sustainability risks, companies may consult the guidelines to which Article 18 Taxonomy Regulation expressly refers. That way, companies will use frameworks that are already in line with the regulations.[64]

For smaller parties, it may be difficult to implement the regulations. It is no mean feat to establish conformity with the provisions of Article 3 Taxonomy Regulation. First, it will have to be reviewed what economic activities underlying the investment product may come under the scope of the regulation. Subsequently, qualifying economic activities will have to be tested for the substantial contribution to the environmental objectives, the relevant technical screening criteria, the precautionary principle of 'no significant harm', and the social minimum safeguards. In order to obtain the necessary information, financial market participants must actively approach companies within their portfolios. The requirements of the Disclosure Regulation may also weigh more heavily on the compliance departments of the companies involved. The costs may be limited by using standardized information templates.[65]

Increasing costs of compliance may be a reason for companies to use the option offered by the regulations not to integrate sustainability risks in their investment decision-making process or investment or insurance advisory process, and/or not to consider the adverse impacts of investment decisions or investment or insurance

60 Article 26 Taxonomy Regulation.

61 Article 26(2) Taxonomy Regulation.

62 C. H. A. van Oostrum, *Groene begripsverwarring: de Taxonomieverordening nader onderzocht*, Ondernemingsrecht 2020/131, para. 5.

63 V. Colaert & A. van Caenegem, *Duurzaamheid gefinancierd: Plichten van financiële dienstverleners*, Working Paper No. 2020/2, www.ssrn.com/abstract=3607146 (accessed 23 Oct. 2020) 10.

64 *See also* European Commission, *Revision of the Non-Financial Reporting*, Inception Impact Assessment (30 Oct. 2020).

65 S. Kröner-Rosmalen, *Duurzaamheidsverplichtingen voor de financiële sector: een overzicht*, 7–8 FRP 30 (2018).

advice on sustainability factors. This strategy may also lead to a competitive advantage as compared to companies that do subject to the full disclosure regime of the regulations. It is hoped and expected that investors will lean towards the latter group of companies, so that there will not be any disadvantage due to sustainability disclosure, but this will, in fact, create a good earnings model.

Considering the foregoing, governments could set the example. In driving the transition to a sustainable economy, the government – national, regional as well as local – will play a crucial role. In their investment decisions, governments and other investors will use standard-based screening criteria to select companies that satisfy certain minimum standards.[66] In this light, it is expected that companies that show verifiable and transparent sustainable entrepreneurship, in accordance with the regulations, will more easily secure finance and business.

The government supervisors will have to monitor and enforce the transparency obligations ensuing from the regulations. The regulations offer supervisors some degree of clarity as to the activities that qualify as (environmentally) sustainable, the transparency obligations that are relevant in that respect, and the way in which those obligations must be complied with. That knowledge will make it easier for the competent authorities to monitor and enforce.

Clarity as to terminology and transparency will offer financial market participants the advantage of gaining more insight into the turning point between green marketing and greenwashing. The sometimes unclear dividing line between the two is associated with differing opinions on sustainability and greenwashing.[67] As a result, companies are not always aware of greenwashing. A possible consequence is that liability risks are mitigated because of misleading communications about the sustainable nature of a financial product.[68]

5. CONCLUSION

This article has reviewed to what extent the Disclosure Regulation and the Taxonomy Regulation are effective in terms of promoting transparency and creating a common terminology with a view to increasing investor confidence. The regulations are a step in the direction of activating the financial sector in the transition to a more sustainable economy. However, many steps are yet to be taken. The regulations have not yet fully matured. The Taxonomy Regulation currently only provides a harmonized definition of environmental sustainability. Social and governance aspects of sustainability have not yet been defined. Market parties and governments will have to develop their own framework for these two terms. This may lead to market fragmentation and limits the degree to which financial products are transparent and comparable. It is self-evident that the foregoing does not help the investor confidence in 'green investments'. As a possible consequence, the process of reorienting capital towards sustainable investment may take more time than would be desired. In a way, this problem seems to be of a temporary nature. In the Taxonomy Regulation the possibility has been created for inclusion of other sustainability concepts in the classification of sustainability. At the same time, given the large number of parties involved in designing and updating definitions and underlying technical screening criteria, there is a risk of 'compromise definitions', which do not provide the desired clarity of terminology. As a result of the fact that the regulations are designed to grow along with the developments, (financial) companies will have to monitor the obligations ensuing from these regulations closely. Including new terms in the Taxonomy Regulation and working out and adjusting the technical screening criteria may impact the disclosure obligations imposed on the companies involved. This may lead to increasing costs of compliance. Nevertheless, with, among other things, these regulations, the Commission has taken a step towards deploying the power of capital to a more sustainable and inclusive economy. Money doesn't make us happy, but it can contribute to making the world a slightly more sustainable place.

66 The Global Sustainable Investment Alliance, *Global Sustainable Investment Review* 3, 7 (2018). *See also* AFM, *Trendzicht* 20 (2020).

67 R. Torelli, F. Balluchi & A. Lazzini, *Greenwashing and Environmental Communication Effects on Stakeholders Perceptions*, Bus. Strat Envt. 407 (2020).

68 E. S. Sijmons, *Klimaatrisico's in de financiële sector: over 'groene zwanen' en een uniform kader tegen greenwashing*, O&F 70 (2020).